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MEMORANDUM FOR:

Mr. William G. Bowdler
Director
Bureau of Intelligence and Research
Department of State

Attached is your personal copy of our memorandum, "Impact of U.S. Arms Sales Restraint Policy", ER 78-10429, CONFIDENTIAL

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MAURICE C. ERNST
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Impact of US Arms Sales Restraint Policy

An Intelligence Assessment

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ER 78-10429
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Impact of US Arms Sales Restraint Policy

Central Intelligence Agency
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Key Judgments

Until mid-1978, US arms restraint policy had not led to, and could not have been expected to bring about, reductions in the volume of global arms sales to the Third World. The increase in Soviet, French, and West German sales, which more than offset the fall in US sales, reflects mainly the fruition of ongoing negotiations and commitments. At the same time, efforts by these countries for negotiating future sales contracts continue unabated.

- Negotiations on most recent arms agreements predate the US policy.
- Countries denied equipment by the United States have not had sufficient time to line up alternative suppliers.
- Only one US client is known to have withdrawn its request for arms, rather than be turned away, although others may have decided not to ask for US equipment.
- For political reasons, few important US clients would transfer to Moscow orders turned down by Washington.

In the longer run, we expect Western suppliers to exploit all arms sales opportunities, including those created by the US arms restraint policy. Western Europe will try to increase its share of a market that probably will not gain over the next several years. Even though Western governments and the USSR are paying lipservice to cooperation in sales restraint, none has yet seriously entertained sales restrictions. Instead, they continue to pursue arms sales vigorously in their traditional markets and to look for new sales opportunities.

If US restraints continue to be applied unilaterally, West European suppliers can provide a reasonable alternative to US supplies and can readily meet the level of technical sophistication required by Third World customers. Western Europe also could handle larger orders. None of these countries is expected to turn down orders, which are needed for jobs, export earnings, and

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lowered unit costs on equipment produced for their own services. Even though West European firms are not expected to expand capacity, they can readily accommodate larger orders by (a) giving priority to foreign sales, (b) expanding order backlogs, or (c) taking equipment from their own inventories.

The Soviets have little to gain from US restraints because the global arms market is highly segmented, largely along political lines. Nor do we see any advantage for the Soviets to cooperate by reducing their arms sales, despite a willingness to discuss the issue. Moscow has found arms transfers a highly effective foreign policy tool—for gaining entree into areas that would be otherwise denied to it, maintaining influence over the attitudes of client governments, and garnering large amounts of badly needed hard currency.

Impact of US Arms Sales Restraint Policy

The 1977 Record

Global arms sales in 1977 rose 12 percent, to $23 billion* (measured in 1976 dollars), despite a 6-percent drop in US sales. Total non-US sales increased by 32 percent, including an almost doubling in West European sales and a 36-percent increase in Soviet sales. We have no evidence that US restraint had any effect on these developments, and indeed would not expect any significant effects to have been reflected in actual sales this soon because of the time (six to 18 months) required to negotiate new contracts.

No major US arms recipient was turned down by the United States during the year, nor is there evidence that large customers sought other suppliers because of concern over future US unwillingness to sell. Most of the negotiations for the $6 billion West European sales in 1977—a record level—had been initiated before the US policy was introduced, and US customers were not involved in the near-record Soviet sales. The jump in 1977 West European and Soviet sales reflects increased short-term marketing opportunities in the Third World, rather than US cutbacks. Until mid-1978 we noted neither a slowing of sales initiatives by non-US arms suppliers nor a decrease in sales to the Third World.

The Supply Picture in 1978-81

After mid-1978, however, LDCs are expected to turn increasingly to non-US suppliers to satisfy their requirements for military goods. Despite lipservice to the concept of restraint we see no reluctance on the part of foreign suppliers to accept LDC orders. West European suppliers, particularly France and the United Kingdom, are likely to continue to push sales vigorously. In general, they view the US policy as a unique opportunity to maintain and even expand their market share in what many expect will be a declining market during the next four to five years.

If the United States pursues its restraint policy unilaterally, smaller clients will be the first to turn to alternative suppliers. Mexico has already withdrawn its request for US fighter aircraft and appears to be looking

*Communist sales are computed on the basis of US export costs, which are about one-third higher than the Communist export costs used for analysis of trade between the Communist countries and less developed countries. If the latter had been used on a current dollar basis, arms sales in 1977 would have amounted to $21.5 billion.

elsewhere. Other countries that have purchased large amounts of US arms also may turn to other sources to eliminate the uncertainty and delays caused by the extended review process. For example, Saudi Arabia, concerned over future US willingness to meet its arms requests, has been sounding out other suppliers for aircraft, armored vehicles, and support equipment.

The West Europeans provide a viable alternative for US arms clients. They possess the capability to provide an almost complete array of hardware needed by LDCs, although delivery schedules may be drawn out and costs are generally higher than in the United States. Moreover, most West European governments face strong economic pressures to press arms sales. Technological advances and the ever rising costs of weapon systems, coupled with limited domestic markets, make arms exports increasingly attractive. While the general slowdown in economic growth in Europe has increased pressure to maintain employment in defense industries, the Europeans—especially the French—also see foreign policy dividends from their arms sales. Moreover, each European country is skeptical about the willingness and ability of its competitors, including the United States, to restrain its arms sales in the long term in the face of growing domestic pressure.

West European arms suppliers apparently are not planning a substantial expansion of production capacity because they do not foresee a sustained increase in arms markets. In any case, West European producers have considerable flexibility in using their production capacity and in adjusting to meet short-term demand. For example, France and the United Kingdom are probably willing to deliver to foreign clients part of the production originally scheduled for their own armed forces. These suppliers also would accept additional orders and build up an order backlog, which they consider desirable as a means of stabilizing employment levels.

France

France, the largest and most aggressive arms exporter in Western Europe, has resisted pressures for arms restraint cooperation while hoping to capitalize on US unilateral restraints. Paris can supply a nearly complete line of military hardware and stands willing to supplant the United States as a source of weapons. The current French arms sales campaign is reminiscent of the mid-1960s when France made the Mirage family of jet fighters available to Latin American nations; at that time the United States had restricted military credits to Latin America and had refused to introduce new or sophisticated weapons systems, primarily jet fighters, into the area. France has subsequently sold more than 90 of these aircraft to five Latin American countries.

The United Kingdom

Despite earlier signs of possible British cooperation in arms restraint, British support has diminished in the past six months because of (a) French

reluctance to cooperate on the arms restraint issue and (b) unemployment in the shipbuilding industry, lagging orders in the aircraft industry, and underutilized capacity for armored vehicle manufacturing. To help alleviate this situation and possibly to cash in on some US sales rejections, the British have mounted a major arms export drive. In early 1978 a Royal Fleet auxiliary ship, with a miniarms show on board, toured Latin America and South Asia. A British aircraft industry team recently concluded a 30-day Middle East sales tour, during which the Hawk jet trainer/attack aircraft was demonstrated in Saudi Arabia, Kuwait, Abu Dhabi, Dubai, Egypt, Qatar, Muscat, and Jordan. A major sales promotion for the Jaguar jet fighter is also being mounted in India and Latin America. Finally, industry and government sales efforts will be pushed further this summer at the Aldershot army exhibit and Farnsborough air shows.

West Germany

The West Germans have been the most responsive among West European nations to US arms restraint urgings, largely because they have little to lose. Bonn has the most restrictive arms export policy in Europe. Aircraft and ground armaments over the next several years will be produced to fill domestic needs for the most part, although some production will be directed toward the needs of smaller European allies. Nonetheless, in ship construction, where major unemployment problems have arisen (because of declining demand for dry cargo ships and tankers), the Germans appear to be aggressively pushing Third World sales. Moreover, exports of equipment that is coproduced with France in a joint company headquartered in France will be affected by the French aggressive arms sales campaign.

Other European Suppliers

Most other European arms exporting countries, including Belgium, Italy, Spain, Sweden, and Switzerland, hope to increase their arms sales over the next few years for economic reasons. They are capable of supplying a wide range of specialty items—from helicopters and tanks to radars, communications equipment, and naval ordnance. While many of them manufacture hardware under US license, they have also developed a parallel series of domestically produced goods which they are anxious to export.

Soviet Union

The Soviets pose as the principal force in the world on behalf of disarmament and have readily entered into a dialogue on arms restraint with the United States. If Moscow were to cooperate, its policy would have to parallel ours. Practically, no substitution of Soviet arms for those of the United States is possible because most US sales are in markets where the USSR does not compete. If the United States were to relinquish portions of its market, Moscow would be much less likely than Western Europe to fill the

void. Although the Soviets would be willing to expand sales, even at the expense of their own current stocks, major US clients such as Saudi Arabia, Iran, and Israel would not likely turn to Moscow for arms.

In the two meetings since last December, between Moscow and Washington, there has been no substantial commitment on parallel restraints by Moscow. Moreover, we see little reason for the Soviets to agree to any meaningful limit on conventional arms transfers to LDCs unless it were brought into the broader context of strategic arms limitations or balance of forces. The small cost of arms exports to the Soviets relative to their high political payoff has been proved over time: these transfers give Moscow its major entree to the Third World. Because Moscow has been willing to provide military equipment and training with a minimum of stated conditions and on attractive financial terms, it has been able to establish a strong presence in countries otherwise denied to the Soviets.

In recent years, the commercial aspects of the arms supply program also have become important to the USSR. Syria, Libya, Iraq, and Algeria—among Moscow's largest arms clients—have various degrees of access to Arab oil wealth and are willing to pay in hard currency. In 1977, the USSR earned approximately $1.5 billion in hard currency through military deliveries to the Third World.

Other Communist Suppliers

The East Europeans have played a relatively passive role in selling arms to the Third World. They have acted as an adjunct to the Soviet program, providing reconditioned weaponry, support equipment, and ammunition. They, like the Chinese, do not supply substantial quantities of arms to the Third World; their limited production capacity is devoted primarily to meeting domestic requirements.

The Market in 1978-81

In the next several years we expect sales to Third World countries to hover around the $20 billion average of 1974-76 (in 1976 dollars). This projection is based largely on our estimate that demand in the Middle East—which has accounted for 70 percent of the total in the past four years—will slacken.

Iran, which has made up 35 percent of Middle Eastern demand, has completed the major part of its armed forces expansion and infrastructure development. Purchases, while expected to remain high, should fall below the record levels of recent years. Major anticipated purchases include an additional 70 F-14 and 140 F-16 jet fighters, as well as some ground forces equipment.

Saudi Arabian demand probably will decline sharply since most of the expansion and modernization of the armed forces has been completed.

Activity by the Saudis probably will be limited to replacing the 110 F-5 jet fighters in their inventory, acquiring equipment to mechanize their last two infantry brigades, and buying helicopters to provide additional mobility to the Army.

Iraq, which probably will continue to depend largely on the USSR for arms, almost certainly will try to obtain some 200 jet fighters, along with 500 tanks and armored personnel carriers. Purchases from Western suppliers will probably be confined to French Mirage fighter aircraft, antitank missiles, and support equipment.

Egypt, cut off from Soviet hardware since 1974, stands in desperate need of equipment. Any resupply program will be circumscribed by Cairo's ability to line up financing from Saudi Arabia and other Persian Gulf supporters. Purchases probably will amount to about 100 supersonic jet fighters, 100 to 150 jet trainers and light attack aircraft, 200 tanks, armored personnel carriers, and surface-to-air missile equipment.

Syrian purchases also will be constrained by the largesse of Persian Gulf backers, as well as by Soviet willingness to extend credits.

Libyan demand is expected to stay within the limits of recent orders.

Although various other Third World countries are starting their reequipment cycle, their appetites for arms are small and their pocketbooks lean compared with Middle Eastern countries. The best sales possibilities are in the Asian subcontinent and in those Latin American countries looking to modernize their armed forces. India and Pakistan are in the market for a combined total of 350 deep-penetration fighters. Supersonic jet fighters also head the list of demands by Venezuela, Mexico, Ecuador, Brazil, and Argentina, which are seeking a total of about nine squadrons (about 100 planes). The latter three countries have a combined requirement for more than 200 tanks. Mexico, Colombia, and Ecuador are shopping for some 20 small, fast guided-missile patrol boats.

Countries in East Asia and Africa are beginning to expand and modernize their forces, but their requirements still are on a small scale. Together, these countries have expended only $2.5 billion annually in the past four years. Even if these expenditures were to increase by 50 percent, they would not take up the anticipated slack in Middle East purchases. Indonesia, South Korea, and Taiwan plan to replace a large array of equipment in all branches of service. Sub-Saharan African countries appear primarily interested in modernizing their unpretentious military establishments. Lack of skilled manpower, infrastructure, and funds tend to confine equipment orders to small amounts of fairly basic equipment. Nonetheless, a short-term increase in arms flows is to be expected in the Horn, for the modernization programs in Nigeria, Kenya, and Tanzania, and in southern Africa for the expansion of forces bordering Rhodesia and South Africa.

The fastest growing portion of military transfers to the Third World will probably lie in the nonhardware field. Technical assistance and spare parts already comprise between about 20 percent of Soviet sales and 30 percent of US sales. As equipment purchases have increased in both quantity and sophistication, the demand for training, technical services, and spare parts has multiplied. Saudi Arabia, Iran, and Oman have already found it necessary to contract for packaged support programs, which include equipment maintenance, construction of facilities, training of personnel, and regularized procurement of spare parts. This trend will continue as the introduction of new weapon systems increases the strain on indigenous manpower resources.

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